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Review of the efficiency of the administrative and financial functioning of the United Nations

Report on the implementation of the recommendations of the Office of Internal Oversight Services on the Investment Management Service of the United Nations Joint Staff Pension Fund

Report of the Secretary-General*

Summary

The present report is being submitted pursuant to General Assembly resolution 279 of 23 December 2003, in which the Assembly took note of the report of the Office of Internal Oversight Services on the audit of the Investment Management Service of the United Nations Joint Staff Pension Fund and requested the Secretary-General to ensure that all the recommendations of the Office of Internal Oversight Services contained in the report were fully and expeditiously implemented and to submit a report thereon during the resumed part of its fifty-eighth session.

* The report is being submitted after the deadline for publishing owing to the need for consultations with various entities.

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I. Introduction

1. The United Nations Joint Staff Pension Fund (UNJSPF), a pension fund for employees of the United Nations and 18 related agencies, was established in 1949. The operational administration of the Fund is entrusted to the Chief Executive Officer, who also serves as Secretary of the United Nations Joint Staff Pension Board.

2. Management of the investment of the Fund's assets is the fiduciary responsibility of the Secretary-General of the United Nations, who acts in consultation with the United Nations Investments Committee, taking into account the observations of the United Nations Joint Staff Pension Board and the General Assembly on policy issues. The Under-Secretary-General for Management is designated as the representative of the Secretary-General for the management and administration of the investments of the Fund on behalf of the Secretary-General. The representative is assisted by the staff of the Investment Management Service, which manages the Fund's portfolio.

3. The Office of Internal Oversight Services conducted its audit of the Investment Management Service between September 2001 and March 2002, covering the operations of the Service during the biennium 2000-2001. The Office presented its final internal report to the United Nations administration in October 2002, in which it issued a total of 29 recommendations, identifying weaknesses in areas relating to governance and strategies, investment management practices and procurement and contract administration. After the issuance of that internal report, the Investment Management Service had implemented a number of the recommendations, and therefore the report of the Office of Internal Oversight Services to the General Assembly (see A/58/81) contained only 18 of the original recommendations. As requested by the Assembly, the present report will provide an update on those recommendations contained in the report of the Office of Internal Oversight Services as well as an overall update on the multi-pronged action being taken for implementation of the recommendations.

II. Overall comprehensive action being taken

4. It may be recalled that in her statement to the General Assembly during the main part of its fifty-eighth session in October 2003, the Under-Secretary-General for Management, Catherine Bertini, who is the representative of the Secretary-General for UNJSPF, informed the Assembly that upon her assumption of responsibilities as representative on 1 April 2003, she had embarked on a review of the status of implementation of recommendations of the Office of Internal Oversight Services. These recommendations had been accepted by her predecessor, and on some of them implementation had either begun or had been completed. That review was undertaken by the global consulting firm Deloitte & Touche, whose report can be briefly summarized as follows:

(a) The recommendations of the Office of Internal Oversight Services did not indicate a collapse of procedures or controls but, rather, gaps in some processes outlined in the Investment Management Service Organization, Policies and Procedures Manual;

(b) Many of the audit recommendations of the Office of Internal Oversight Services were based on the fact that the Investment Management Service did not possess the requisite operational technology to automate controls and produce audit trails;

(c) The most significant outcome of the audit was the recognition that UNJSPF and the Investment Management Service were unique among pension funds, and that broad issues such as plan governance, investment strategy and the overall investment process and operations of the Investment Management Service would need to be re-examined as part of a comprehensive review.

A. Status of implementation of audit recommendations

5. The representative of the Secretary-General also provided the General Assembly with information on the general status of implementation of the audit recommendations, as follows:

Core issues	*Number of recommendations*	*Outstanding recommendations*
Procedures and controls	8	0
Documentation	9	0
Human resources/staff issues (succession plan, continuing education, etc.)	4	1
Plan governance/strategy	5	4

6. The detailed responses to recommendations of the Office of Internal Oversight Services and specific implementation actions taken by the Investment Management Service, as reviewed and verified by the consulting firm, are set out in the annex to the present report.

B. Comprehensive review of investment management practices and procedures

7. In addition to the review of the implementation of recommendations, the consulting firm made the recommendation that the United Nations conduct comprehensive analyses of fund governance and strategy and investment process and operations. It was proposed that there be done on two parallel tracks, allowing immediate progress in modernizing the Investment Management Service while the larger multilateral issues of governance and strategy were given full consideration.

8. The two-track approach is as follows:

(a) Track I — assessment of governance and strategy, addressing:

(i) Re-evaluation of Pension Board resolutions and the definitions of fiduciary responsibility;

(ii) Roles and responsibilities of constituents (Secretary-General, Under-Secretary-General, Investments Committee, Pension Board, Investment Management Service);

(iii) Overall investment objectives and strategy;

(iv) Asset allocation;

(b) Track II — investment process and operations:

(i) Organizational structure and investment decision-making process of the Investment Management Service;

(ii) Use of non-discretionary and discretionary advisers;

(iii) Approval requirements to execute transactions;

(iv) Business case for increased technology in the Investment Management Service;

(v) Trade monitoring/document management.

9. At present, Track I (i), (ii), and (iii) have been deferred, as the Office of Internal Oversight Services has undertaken a further audit of the governance of UNJSPF.

10. Track II and Track I (iv), on asset allocation strategy, were set in motion last year. A request for proposal was released on 19 February 2004 to companies that expressed interest in and showed competence for conducting this review.

11. The request-for-proposal process is to be completed and the appropriate company finally selected by the end of April 2004. The specific scope and coverage of the request for proposal, which includes all the areas of study recommended by Deloitte & Touche, as well as of a more recent internal audit of the investment performance management system by the Office of Internal Oversight Services, are set out as follows:

(a) Assess the risk/return profile of the Fund in the context of General Assembly resolutions and client (Pension Board) mandate;

(b) Evaluate investment objectives of the Fund in the context of its asset/liability position and in accordance with the fiduciary responsibility of the representative of the Secretary-General for the investments of the Fund and the Investment Management Service, with the company selected acting as her agent;

(c) Evaluate by asset and sub-asset class the long-term historical performance of the Fund in the context of (a) and (b) above;

(d) Assess asset allocation strategy and process versus alternatives;

(e) Evaluate the current organizational structure and procedures, including but not limited to:

(i) Supplementary research capabilities supplied by the non-discretionary advisers versus alternative structures;

(ii) Documentation requirements, the adequacy thereof and compliance therewith;

(iii) Control mechanisms;

(iv) Reporting procedures and communications;

(v) Use of discretionary advisers;

(vi) Cash projection report requirements;

(vii) Use of the approved list;

(viii) The proper role of the manual in the investment process;

(ix) Role of the Investments Committee;

(x) Evaluation procedures regarding internal staff and external investment service providers;

(f) Assess the appropriateness of alternative investments in the context of (a) and (b) above in pursuing the goals and objectives of the Fund, including analysis of expected portfolio performance contribution and risk, as well as cost and specific resources and skills required in the Investment Management Service for implementation;

(g) Assess the effectiveness, risk and costs of currency hedging versus currency management through diversification. Propose implementation programmes for any recommended changes, including specific resources and skills required in the Investment Management Service for implementation;

(h) Evaluate information technology infrastructure and recommend hardware and software tools to augment the current technological base for investment management in the Investment Management Service, including cost estimates and staff requirements, if any;

(i) Evaluate the current use of three custodians plus a Master Record Keeper for custody and record keeping, performance measurement and reporting of the Fund's assets;

(j) Propose a management structure for the Fund's real estate investments, including specific resources and skills required in the Investment Management Service for implementation;

(k) Assess the Fund's current benchmark and discuss alternatives if appropriate;

(l) Assess staffing levels, functions and structure in the Investment Management Service, specifically as regards:

(i) Number and functions of portfolio managers;

(ii) Buy-side research support by non-discretionary advisers versus alternative structures;

(iii) Investment support staff;

(iv) Operations staff;

(v) Information technology staff;

(vi) Administrative staff;

Include cost estimates for any changes recommended;

(m) Propose an effective and cost-efficient compliance structure for the Investment Management Service;

(n) Analyse and evaluate the current cost structure of the Investment Management Service, including compensation of staff, fees paid to discretionary and non-discretionary managers and payments for the use of external research sources and databases.

12. The resulting report would include a mission statement for the Investment Management Service, a detailed evaluation of its practices and a comparison of those practices with investment management industry practice, as well as a comprehensive evaluation of the effectiveness of current conditions and results vis-à-vis recommended changes, supported by anecdotal evidence of experience with other clients and by data demonstrating quantifiable and verifiable metrics validating the successful adding of value through the recommendations. The finished product of this project would be a detailed road map that the Investment Management Service could use to improve the management of the pension programme within the parameters set forth by the General Assembly, the Office of Legal Affairs and the Pension Board. The implementation time scale, internal and external resource requirements, expenditure on technology and other capital expenditures for all proposed changes would be fully articulated, as would expected enhanced returns net of cost vis-à-vis historical returns of the Fund.

13. The scope of the request for proposal demonstrates the desire of the representative of the Secretary-General to address the audit issues not simply as they relate to the specific recommendations of the Office of Internal Oversight Services but in a much more comprehensive and extensive manner that would bring about the adoption of good investment business practices in the Investment Management Service.

14. In addition to the request for proposal that was formulated, the representative of the Secretary-General has in the past few months adopted the initiatives set out below.

1. Adoption of a code of professional conduct for investment officers

15. Effective 1 January 2004, all investment officers and other investment assistants of the Investment Management Service who make investment decisions or who have access to investment instruments and relevant accounting records were required to agree to conform to the professional code of ethics of the Association for Investment Management and Research (AIMR). In addition, they were required to submit on an annual basis, starting in 2004, the financial disclosure required under regulation 1.2 (n) of the United Nations Staff Rules, which prescribes the procedures and form for financial disclosure. These were immediate measures undertaken to address the long-standing concern of both the internal and external auditors regarding the absence of a code of professional conduct for the investment officers of the Investment Management Service. These were immediate steps to address this serious issue, but in the long term, the development of a code of conduct for investment officers specific to the United Nations system should be undertaken.

2. Use of competitive procedures and the advice of the Office of Legal Affairs in the procurement of services by the Investment Management Service

16. Another significant issue raised by the internal auditors was the non-application by the Investment Management Service of competitive procedures in the procurement of services of advisers and consultants, specifically in the renewal of contracts of investment advisers. In the most recent months, this has completely changed. Competitive procedures were used, and the services of the Procurement Division and the advice of the Office of Legal Affairs were sought in the renewal of some contracts. The introduction of competitive procedures has already resulted in getting better value for the organization in terms of fees.

17. With a view to enhancing the capacity of the Investment Management Service, arrangements have also been made for the temporary assignment of a legal officer to do a thorough review of all contracts to which the Investment Management Service is a party and to strengthen its documentation and procurement procedures, among other tasks.

3. Appointment of a new Director

18. The appointment of a new Director of the Investment Management Service has recently been approved by the Secretary-General. The new Director, who is expected to be on board by mid-May 2004, brings to the Service very extensive experience in investments and is a proven manager and leader in prominent investment companies in various countries.

Annex

Status of implementation of recommendations of the Office of Internal Oversight Services

1. As outlined in paragraphs 34 to 65 of the report of the Office of Internal Oversight Services, the audit recommendations cover two main areas, namely, investment management and procurement and contract administration. The administration's responses to the recommendations pertaining to procurement and contract administration were reflected in that report, and the implementation of the recommendations is under way as per the schedules indicated in the same report. Recommendations on both areas and the implementation thereof are set out below:

A. Investment management

Recommendation 1

2. The Investment Management Service should revise its Organization, Policies and Procedures Manual and the manual of the Operations Section to ensure that all policies and procedures governing the work of the Service are fully documented, updated and formally approved. The manuals should reflect the current organization chart and flow of operations, specify internal controls in the investment management process and clearly define the functions and responsibilities for investment decision-making, execution of transactions and monitoring of the performance of investment managers (AS2001/95/1/01).[a]

3. *The manuals have been updated, and the consulting firm has confirmed this.*

Recommendation 2

4. In order to provide for the proper segregation of duties, the Investment Management Service should revise the existing trading procedures by assigning the function of initial verification of trade confirmations to the Operations Section, which should receive all trade confirmations directly from brokers (AS2001/95/1/02).

5. *The trading procedures have been revised and the manuals have been updated. The consulting firm has confirmed this.*

Recommendation 3

6. The Investment Management Service should establish realistic validity periods for executing approved transactions and include those requirements in the Organization, Policies and Procedures Manual (AS2001/95/06).

[a] Such symbols in parenthesis refer to internal codes used by the Office of Internal Oversight Services for recording recommendations.

7. *While the manual has been updated, the consulting firm has pointed out that industry practices would not suggest the imposition of such time limits. Rather, the merits of buy and sell decisions would be determined by the money manager. As a next step, the consultants have suggested that a comprehensive analysis of Fund governance, strategy, investment process and operations be conducted. This is being done, as indicated in paragraphs 7 and 8 above in the main report.*

Recommendation 4

8. The Investment Management Service should ensure that approvals of recommendations and trade orders are properly documented and filed and that any verbal instructions given by authorized officials on an exceptional basis are also documented to provide a management trail (AS2001/95/1/08).

9. *The Investment Management Service is in complete agreement with this recommendation and has always followed the proper practice. The only two occasions when swift action had to be taken on an emergency basis were after the extraordinary events of 11 September 2001, with the lengthy closure of the United States financial markets, and during the precipitous market downturn in October 1997. The related documentation, on both occasions, was signed by two duly authorized officials. In any case, as indicated in paragraphs 7 and 8 above in the main report, this issue will also be revisited in the context of the overall analysis that is being conducted.*

Recommendation 5

10. The Investment Management Service should review the current investment process, including the authorization requirements for investment transactions and the use of "full-service" brokers and non-discretionary advisers, in terms of the value of services provided, as well as any excessive costs and duplication of tasks associated with this practice (AS2001/95/1/16).

11. *The role of the non-discretionary advisers will be reassessed as part of the broader review of investment management processes. As a next step, this is included in the scope of the study on paragraph 11 (e) above in the main report.*

Recommendation 6

12. The Investment Management Service should obtain a cost breakdown by type of service rendered for each non-discretionary advisory services contract and require it in future requests for proposals for such services (AS2001/95/1/17).

13. *The question of breakdown of fees was referred to the Procurement Division. The Investment Management Service has since requested and received fee breakdowns. This has been confirmed by the consultants.*

Recommendation 7

14. The Investment Management Service should ensure that monitoring procedures are formalized and that reviews of the quarterly reports submitted by the small capitalization managers are adequately documented (AS2001/95/1/19).

15. *Benchmark reports are now included in the Investment Committee Blue Book and accepted by the Office of Internal Oversight Services.*

Recommendations 8 and 9

16. The Investment Management Service should:

(a) Establish more appropriate reporting lines and clearly delineate functional responsibilities in accordance with operational requirements (AS2001/95/1/21).

(b) Reassess the requirements for additional investment officers, especially for North American Securities, and/or consider outsourcing a portion of the North American equity portfolio to outside discretionary investment managers (AS2001/95/1/22).

17. *These recommendations are beyond the authority of the Investment Management Service, as they fall under governance and strategy. Furthermore, as indicated above in the main report, the representative of the Secretary-General has deferred plans to commence action on track 1 of her two-track approach because of the decision of the Office of Internal Oversight Services to do an audit of governance and strategy for the United Nations Joint Staff Pension Fund as a whole.*

18. *It may be mentioned here that, in its report, the consulting firm recommended that the reporting structure of the Investment Management Service, in particular the role of the Director, be re-evaluated. With the appointment of the new Director, the representative of the Secretary-General intends to use this opportunity to evaluate and enhance team objectives, roles and responsibilities as well as introduce a new management culture.*

Recommendation 10

19. The Investment Management Service should develop a comprehensive code of ethics for its staff involved in investment management and incorporate it into the policy manual, and should require all investment staff to acknowledge annually in writing that they have read and understood the code (AS2001/95/1/23).

20. *As indicated to the Fifth Committee in October 2003, the Under-Secretary-General for Management is committed to strictly enforcing the United Nations code of ethics for all staff members, especially for staff members involved in investment operations, and for this reason the staff of the Investment Management Service have been requested to adhere to the code of professional conduct of AIMR, effective 1 January 2004* (see para. 15 above in the main report).

Recommendation 11

21. The Service should ensure that appropriate benchmarks are identified in order to evaluate the performance of investment officers and that investment performance reports are customized and attached to Performance Appraisal System reports (AS2001/95/26).

22. *The Investment Management Service has changed procedures to address compliance with this recommendation, and investment performance is now reflected in the performance appraisals of staff.*

B. Procurement and contract administration

Recommendation 1

23. The representative of the Secretary-General for the investments of the Pension Fund should review the current contract-signing arrangements concerning agreements/contracts for investment services and make alternative arrangements in order to provide for adequate separation of duties (AS2001/96/1/01).

24. *Contract-signing arrangements have been revised* (see paras. 16 and 17 above in the main report).

Recommendation 2

25. The Investment Management Service should establish, in cooperation with the Pension Fund secretariat, the terms of reference of the procurement function in the investment area (AS2001/96/1/02).

26. *Procurement procedures in the Investment Management Service are being put in place in cooperation with Procurement Division* (see paras. 16 and 17 above in the main report).

Recommendation 3

27. The Investment Management Service should issue detailed procedures covering all phases of the purchasing process, including requisitioning, contracting, receipt of goods and services, evaluation of contractor performance, certification of invoices and processing of payments. The Service should also develop a user manual for the record management database system (AS2001/96/1/03).

28. *The development of these procedures will be undertaken by the legal officer in close consultation with Procurement Division* (see paras. 16 and 17 above in the main report).

Recommendation 4

29. The Investment Management Service should ensure that the negotiation of fees and other conditions of agreements and contracts, including the extension of their terms, is done through the Procurement Division, Office of Central Support Services, and that any exceptions to the established procurement procedures are properly authorized and documented (AS2001/96/1/04).

30. *Implemented* (see paras. 16 and 17 above in the main report).

Recommendation 5

31. The Investment Management Service should comply with the United Nations procurement policies and requirements: (a) to conduct periodic vendor evaluations in order to assess performance and to validate the continued use of a vendor's services and (b) to process extensions of contracts through the Procurement Division and to submit them to the Headquarters Committee on Contracts for its review when required (AS2001/96/1/08).

32. *Implemented* (see paras. 16 and 17 above in the main report).

Recommendations 6 and 7

33. The Investment Management Service should:

(a) Implement an automated procurement system in order to establish control over the procurement process (AS2001/96/1/10);

(b) Ensure that all procurement requests are formally documented, authorized and/or approved before their submission to requisitioning officers and that the requests are properly logged for audit trail purposes (AS2001/96/1/11).

34. *The automation of the procurement system will be part of the evaluation of the information technology system in Investment Management Service that is incorporated into the overall review of investment management practices* (see para. 11 (h) above in the main report).